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AUSTRALIA + NEW ZEALAND

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## WEEKLY COMMENT: FRIDAY 10 JUNE 2022

1. The *Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022* (“the March 2022 Tax Act”), which received the Royal assent on 30 March 2022, contains the new rules relating to interest deductibility for residential properties and the corresponding changes to the bright-line test. Inland Revenue issued *Special Report on Public Act 2022 No 10* (“the March 2022 SR”) on 31 March 2022 on interest limitation and additional bright-line test rules.
2. Last week I began reviewing the additional bright-line test rules. I looked at the new bright-line test rules, the bright-line acquisition dates, and the implications for co-ownership of property. This week I look at the rollover trust rules.

### **Rollover trust rules**

3. New s CB 6AB provides rollover relief when residential land is transferred to or from a family trust on or after 1 April 2022, provided certain conditions are met, as discussed below.
4. Inland Revenue notes on page 171 – 172 of the March 2022 SR that relief from taxation under the bright-line test is provided in certain common situations where there is a legal transfer of residential land, but no change in economic substance, under the rollover rules, which allow:
  - (a) Disposals at the transferor’s acquisition cost or less to be ignored, with the transferor’s cost base applying to the recipient;
  - (b) Other disposals to be taxed based on the actual consideration received; and
  - (c) The original bright-line acquisition date for the transferor to continue to apply to the recipient.
5. Section CB 6A(7) concerns land transferred to trustees or original settlors of certain family trusts, for which the bright-line acquisition date is given by s CB 6AB. For this purpose a “rollover trust” is defined in s CB 6AB(5) as meaning, at the time of a relevant transfer to or from a relevant trust:
  - (a) All relevant transfers (on or after 1 April 2022) to trustees, or to original settlors, are by beneficiaries or to beneficiaries, as applicable, 1 of whom is a principal settlor (for example: if the land is transferred to 2 people who are original settlors, then they must be beneficiaries of the trust, in addition to any other capacity they might have, and 1 of them must be a principal settlor); and

- (b) All principal settlors are beneficiaries of the trust; and
  - (c) All principal settlors are close family associates, meaning:
    - (i) They are within 4 degrees of blood relationship; or
    - (ii) They are married, in a civil union, or in a de facto relationship; or
    - (iii) 1 person is within 4 degrees of blood relationship to the other person's spouse, civil union partner, or de facto partner; and
  - (d) All beneficiaries are either trustees of another trust where at least 1 beneficiary of the other trust is a close family associate of a beneficiary of the relevant trust, or are close family beneficiaries, meaning a beneficiary that is 1 or more of the following:
    - (i) A principal settlor;
    - (ii) A close family associate of another beneficiary who is also a principal settlor;
    - (iii) A company, which is at least 50% owned by a beneficiary of the trust that is a close family associate of another beneficiary that does not meet the principal settlor requirements for the trust;
    - (iv) A charity registered under the Charities Act 2005.
6. Inland Revenue notes in the March 2022 SR (on page 176) that the definition of "close family associates":
- (a) Includes relatives by adoption, as section 16(2) of the Adoption Act 1955 deems adopted children to be the natural children of their adoptive parent;
  - (b) The extension of the 4 degrees of blood relationship to the other person's spouse extends coverage of the association test to include stepchildren and in-laws;
  - (c) The rules mirror the existing associated person rules in section YB 4 but with an expansion from two degrees to four degrees of association to account for the fact that many family trusts include a wider range of family members than simply those only two degrees removed.
7. The rules applying to rollover trusts are as follows:
- (a) Under s CB 6AB(1), if a trustee holds land on a rollover trust, the bright-line acquisition date, when the trustee disposes of the land, is the bright-line acquisition date the settlor had for the land before transfer to the trustee, providing the transfer to the trustee is on or after 1 April 2022;
  - (b) Under s CB 6AB(2), if an original settlor holds land transferred back to them from a trustee of a rollover trust that the original settlor settled, the bright-line acquisition date, when the original settlor disposes of the land, is the bright-line acquisition date the trustee had for the land before transfer to the original settlor, providing the transfer to the original settlor is on or after 1 April 2022, however, under s CB 6AB(3):
    - (i) The land transferred back from the trustee must be the same land they originally settled and all other settlors also get back their land; or

- (ii) If the land is a part of other land, the part they originally settled and all other transfers of the remaining land back to other original settlors are in the same proportions as in the original settlement;
  - (c) Also under s CB 6AB(3), the transfers under s CB 6AB(1) and (2) may be to or from the person in a different capacity, for example, A and B may have settled the land on the trust in their own personal capacities, but they may have it transferred back to themselves in their capacity as shareholders in an LTC;
  - (d) Under s CB 6A(4), if a person transfers the same land to themselves in a different capacity, and there is no intervening transfer to a third party, then the bright-line acquisition date for the land when they dispose of it to a third party in that different capacity is the bright-line acquisition date that the person first had for the land, providing the transfer to the different capacity is on or after 1 April 2022, and is not to or from a person in their capacity of settlor, beneficiary, or trustee.
8. The effect of the combination of s CB 6AB(2) and s CB 6AB(3) is that rollover relief is only available where residential land held on a family trust is transferred back to the original owner (or owners) in the same proportions they had before.
9. In relation to direct resettlement transactions, Inland Revenue notes in the March 2022 SR on page 173 that:
- “It is intended that relief should be available for trust resettlements when the trustees of a trust transfer residential land to the trustees of another trust, provided that a principal settlor of the new trust is also a principal settlor of the first trust and the new trust satisfies all the requirements of section CB 6AB(5) in relation to its beneficiaries. However, the current legislation does not permit a direct resettlement to qualify for relief, unless the trustee resettling the property is a beneficiary of the new trust. It is intended that an amendment should be included in the next available tax bill.”
10. Inland Revenue also notes in the March 2022 SR (on page 178) that relief may also apply when:
- (a) Residential land is transferred from a look-through company (“LTC”) or partnership to a family trust (where land may be settled on the trust by a person in a different capacity to the capacity in which they are a beneficiary)); or
  - (b) A person received land back from a trust they settled it on, but in a different capacity to the capacity in which they settled it.
11. Section CB 6AB(8) provides that s CB 6AB does not apply for the transfer of shares in an LTC to or from a trustee. Inland Revenue notes on page 179 of the March 2022 SR that this means the relief will not apply when shares in an LTC are transferred to a rollover trust, nor when such shares are transferred back to the original settlors.

### **Application of land-rich trust anti-avoidance rule**

12. Inland Revenue notes on page 181 of the March 2022 SR that:

“After a transfer of residential land that qualifies for relief is made to a trust, if new beneficiaries are added with the purpose of defeating the bright-line test, the land-rich trust

anti-avoidance rule in existing s GB 53 applies to reverse the relief by deeming the recipient to have disposed of the land at market value.”

### **Transfers to or from LTCs and partnerships**

13. Section CB 6AB(4) if a person transfers residential land to themselves in a different capacity (such as a shareholder in an LTC or a partner in a partnership) and there is no intervening transfer to a third party. The section provides that the person’s bright-line acquisition date for the land when they ultimately dispose of it to a third party is the bright-line acquisition date they first had for the land.
14. Inland Revenue notes on page 186 of the March 2022 SR that:

“This is intended to apply to transfers of residential land to or from LTCs and partnerships where each person transferring the land to the LTC or partnership (or acquiring it from the LTC or partnership) has the same ownership interest in the land before and after the transfer. It is also intended to apply when residential land is transferred from an LTC to another LTC with identical shareholding (meaning that the two LTCs have the exact same owners who each hold the exact same proportion of shares in the second LTC as they hold in the first LTC).”

### **Maori rollover trust rules**

15. Section CB 6A(7B) concerns land transferred to Maori authorities, or similar eligible persons, for which the bright-line acquisition date is given by s CB 6AC in relation to a “Maori rollover trust” defined in s CB 6AC(4) as a trust where all relevant transfers to trustees under s CB 6AC(1) or to original settlers under s CB 6AC(2) are by beneficiaries or to beneficiaries, where all beneficiaries are:
  - (a) Members of the same iwi or hapu;
  - (b) Descendants of the same tipuna; and
  - (c) The land is subject to Te Ture Whenua Maori Act 1993.
16. The rules applying to Maori rollover trusts are as follows:
  - (a) Under s CB 6AC(1), if a Māori trustee (defined as a Maori authority, or eligible to elect to be a Maori authority, under s HF 2(3)(e)(i)) holds land on a Māori rollover trust, the bright-line acquisition date for the land, when the Māori trustee disposes of it, is the bright-line acquisition date that the settlor had for the land before transfer to the Māori trustee, providing that the transfer to the trustee is on or after 1 April 2022;
  - (b) Under s CB 6AC(2), if an original settlor holds land that was transferred back to them from a Māori trustee of a trust that the original settlor originally settled, and the trust is a Māori rollover trust, the bright-line acquisition date for the land, when the original settlor disposes of it, is the bright-line acquisition date that the Māori trustee had for the land before transfer to the original settlor, providing that the transfer to the original settlor is on or after 1 April 2022, however, under s CB 6AC(3):
    - (i) The land transferred back from the trustee must be the same land they originally settled and all other settlers also get back their land; or

(ii) If the land is a part of other land, the part they originally settled and all other transfers of the remaining land back to other original settlors are in the same proportions as in the original settlement;

(c) Also under s CB 6AC(3), the transfers under s CB 6AC(1) and (2) may be to or from the person in a different capacity, for example, A and B may have settled the land on the trust in their own personal capacities, but they may have it transferred back to themselves in their capacity as shareholders in an LTC.

17. Section CB 6A(7C) concerns transfers of residential land included in settlement of claim under the Treaty of Waitangi, for which the bright-line acquisition date is given by s CB 6AE. Under that section, the recipient of a transfer of residential land has the bright-line acquisition date that the transferor had, if the transfer is made on or after 1 April 2022 to a trustee of a trust that is a Maori authority or eligible to be a Maori authority under s HF 2(3)(e)(i) and the residential land:

(a) Is subject to Te Ture Whenua Maori Act 1993; and

(b) Is part of the settlement of a claim under the Treaty of Waitangi.

#### **Disposal and acquisition amounts for transactions covered by rollover relief**

18. Section CB 6A(15) provides that, for the purposes of calculating a person's net income in relation to the disposal of residential land for which they derive an amount of income under s CB 6A, sections FC 9B, FC 9C and FC 9D provide disposal and acquisition amounts for transactions that s CB 6A(7) to (7C) apply to.

19. Section FC 9B provides that for the purposes of calculating a person's net income in relation to the disposal of residential land for which they derive an amount of income under s CB 6A (the general bright-line test) or CZ 39 (the pre-27 March 2021 5-year bright-line test), the disposal amount is the greater of the cost of the residential land to them and the consideration derived for the disposal:

(a) A person transferring land to a trustee under s CB 6AB(1);

(b) A trustee transferring land to an original settlor under s CB 6AB(2);

(c) A person transferring land to themselves in a different capacity under s CB 6AB(4);

(d) A person transferring land to a Maori trustee under s CB 6AC(1);

(e) A Maori trustee transferring land to an original settlor under s CB 6AC(2);

(f) A transferor transferring land to a recipient under s CB 6AE.

20. Section FC 9C provides that for the purposes of calculating a person's net income in relation to the disposal of residential land for which they derive an amount of income under sections CB 6A or CZ 39, if the person is a recipient of a transfer, as described in s FC 9B(a), (b), (c), (d), or (e), then they are treated as acquiring the relevant land for the greater of either its cost to the transferor that transferred it to them or the consideration they give the transferor for the land.

21. Section FC 9D applies to recipients of Treaty of Waitangi residential land and provides that for the purposes of calculating a person's net income in relation to the disposal of

residential land for which they derive an amount of income under sections CB 6A or CZ 39, the person is treated as acquiring the land for its market value at the time the land was transferred from the Crown, if the person is the recipient under s CB 6AE.

**Transfers between companies within a wholly-owned tax consolidated group**

22. Inland Revenue notes on page 187 of the March 2022 SR that:

“An amendment provides rollover relief for transfers of residential land within a wholly-owned group of companies that is a consolidated group under subpart FM. New section FM 15(2B) provides that the recipient company (company B) is treated as having the same bright-line acquisition date for that transferred land as the transferor company (company A). This ensures that the transfer to company B does not reset the bright-line clock.

The restriction of relief to tax-consolidated groups effectively limits the rollover relief to New Zealand resident companies, as non-residents cannot be part of a consolidated group. Similar to the rollover rule for company amalgamations, this ensures that relief is only available on the condition that the property remains within the New Zealand tax base.”



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